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General Business Conditions

THE feeling of relief with which settlement on July 24 of the 53-day steel strike was greeted is tempered both by sober appraisal of the effects of the long work stoppage and by realization of its utter needlessness. At a cost of nearly 21 million tons of ingot steel, and the equivalent in the innumerable variety of fabricated products which American industry requires for its operations, the steelworkers gained a wage increase of 16 cents an hour, with additional fringe benefits of about 5.4 cents. This wage increase in essence had been available to them for the last three months. They also won a modified form of union shop, on terms available for their acceptance some weeks before the final settlement.

Even now, as the steel mills return to full production, stocks in mill yards begin their travels to manufacturers and builders, and ore shipments resume, the long-range effects of the production losses cannot be assessed. Stockpiles of steel and of steel parts and components, built up to ensure continuous and efficient production, have disappeared or become so unbalanced as to stop production. Many manufacturing firms have closed down or curtailed operations, resulting in wage losses to upwards of a million workers outside the steel industry. The next few weeks will bring further curtailment in plants which to date have maintained production from stocks but must now wait for more steel or for parts from seriously hit suppliers. Construction projects of a non-essential nature will be delayed.

The problems of restoring a normal flow of fabricated steel would be formidable at best. For the non-defense industries they are doubly complicated by the priorities which must now be given to delayed defense work. Military production will be speeded where possible, and new orders to allocate steel to various classes of users issue from the National Production Authority almost daily. Civilian work will be slower to resume. Thus the losses of the strike – production losses, wage losses, reduced corporate earnings, and decreased tax yields to federal and state governments – will continue for some time.

Defense Secretary Lovett, in a press conference which is credited with forcing the settlement, predicted that the strike would result in a loss of between 25 and 30 per cent of all armaments scheduled for delivery in this calendar year. He commented, "No enemy nation could have so crippled our production as has this work stoppage. No form of bombing could have taken out of production in one day 380 steel plants and kept them out nearly two months."

The Lesson of the Strike

The steel strike has brought little violence and no loss of life, such as might have occurred years ago in a labor dispute of this magnitude. But if labor relations have improved in that respect, there is little else in the record in which to take satisfaction. All aspects of industrial

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relations have been under unremitting study over the years, and particularly in the last two decades. Theory and practice have evolved and altered, new principles have been developed, and new legislation has been put in force. Undoubtedly great progress has been made in overcoming certain causes of strife, in developing mediation procedures and in replacing violence and bitterness with reason and good faith.

Nevertheless, in this major case a strike of grave consequences has occurred which is shown to have been needless, because it has been settled on terms to which both sides could readily have agreed months ago. The controversy has been characterized by flagrant distortion of facts and intemperance of language, which is the more to be decried because so much of it came from a presumably impartial agent, the Government. The development of normal and effective collective bargaining procedures was impossible from the beginning, because the Government assumed jurisdiction and thereby substituted political bargaining for economic bargaining. It recommended wage increases which went much beyond the established standards for wage stabilization and which would have constituted the largest increases in the steel industry's history. In so doing the Government made it almost impossible, in practice, for the union leaders to accept less.

With respect to the employers, on the other hand, the standard was quite different. The most rigid adherence to the price stabilization formulas was demanded. Settlement on these terms would have fallen to an unbearable degree on the earnings of the companies and on their numerous and widely spread shareholders.

In effect, it was the insistence of government on this "double standard" which led to and prolonged the strike. Mr. Charles E. Wilson, then the Defense Mobilizer, saw this clearly, and his resignation in March was upon that issue. He told President Truman that he had assured his fellow Americans that "both wage and price controls would be administered fairly and without regard to the special demands of pressure groups." The history of the dispute would have been vastly different if this simple principle of equity had been followed, instead of the distortion of fact and faulty reasoning by which the government agencies and officials sought to justify themselves. Against this background also may be judged the statement of Mr. Roger Putnam, the Economic Stabilizer, that the steel companies had "held a loaded gun" at the Government's head to win a price increase. To the steel companies it undoubtedly seemed that the loaded gun had long been pointed at them and held in other hands.

It is to be hoped that this intemperate statement will soon be forgotten along with all the others that were made during the strike. In refreshing contrast to partisan blasts, and a hopeful augury for the future, is the agreement for a joint tour of plants of the U.S. Steel Corporation by Philip Murray, President of the United Steel Workers, and Benjamin Fairless, Chairman of the Board of U.S. Steel, in the interest of better labor relations. Future negotiations, if conducted in this spirit, may avoid the backlash of misunderstanding and partisan bitterness, and build recognition of the real mutuality of labor and management interests.

Meanwhile prices of steel rise, and things made from steel must cost more. Whether the effect is inflationary, as it will be in most cases for at least the short run, or deflationary, as it may prove in the long run because people cannot or will not pay the higher prices, it is unstabilizing. Unfortunately this course was set, for all practical purposes, when the original recommendations of the Wage Stabilization Board were handed down.

Period of "Catching Up" Due

As the immediate effects of the steel strike wear off, a rise in industrial activity, employment and payrolls is to be expected. Arms production will be speeded to make up for recent losses. Concerns which have been obliged to curtail because of lack of steel or steel products will be striving to catch up. Pipelines must be refilled, inventories balanced, and parts supplies produced and stocks built up. All this assures a period of great pressure for production in the whole metal-working area and the highest rate of activity of which these industries are capable. The Federal Reserve index of production for the month of July will show a new low for the year, off possibly as much as 13 per cent from the 1952 peak, due to combination of the steel strike and regular worker vacations, but a sharp rebound is certain for the months ahead.

As this develops, rising personal incomes will encourage further expansion of consumption expenditures. Meantime, inventories of consumer hard goods have been reduced, paving the way for a revival of production in lines heretofore bogged down by excessive stocks. Textiles, which had already turned the corner, have continued their gains. Prices have firmed and production increased. With retail trade generally well maintained and inventories of soft goods in better

shape all along the line, wholesale buying of apparel and other seasonal merchandise for fall delivery has shown an encouraging pickup, promising further support at the production end and for the situation generally.

The net of all this is to postpone further into the future the much speculated-about peak of the production boom generated by the defense program. This conclusion is sustained by the further stretch-out in the rate of national security expenditures revealed in the mid-year report of the President's Council of Economic Advisers. These expenditures, which in January were scheduled to reach a peak plateau of $60 to $65 billion annually by the end of this year, are now not expected to reach that rate until late in 1953.

The Half Year's Earnings

Reports of leading industrial companies issued during the past month show aggregate dollar sales in the first half year maintained close to the 1951 level, but net earnings running below those of 1951 in about seven out of ten cases. Our tabulation of 526 companies, representative mainly of the large manufacturing organizations but including also a limited number in the mining, trade, and service industries, gives combined net income for the half year of approximately $2,098 million after taxes, a decrease of 13 per cent from last year. As was also true in 1951, federal income and excess profits taxes took over half of the operating earnings.

Because of the steel strike, the reports of United States Steel and a number of other leading producers have been delayed and are not available for our tabulation as this Letter goes to press. Of the 23 companies which have reported, net was off 59 per cent for the quarter and 42 per cent for the half year.

For the second quarter alone, net income of the reporting companies was $1,035 million, slightly below the preceding quarter and 12 per cent below the second quarter of 1951. The quarterly trend may be seen from the following totals:

Net Income After Taxes of 526 Leading Corporations
(In Millions of Dollars)

	1950	1951	1952
First quarter	$1,087	$1,233	$1,063
Second quarter	1,287	1,179	1,035
Third quarter	1,410	1,008	—
Fourth quarter	1,399	1,250	—

The rather general declines of earnings in both the second quarter and the first half year reflect, in varying degree, the impact of four adverse factors. One was the slump in sales experienced by many manufacturers as a result of their customers' efforts to reduce inventories. Another was the continuing advance of costs for direct labor, pensions, etc., which could not be covered by increases in selling prices. A third factor was the downtrend of wholesale commodity prices in 1952—reversing the upsurge which tended to swell earnings in 1951. Still a fourth factor was the loss from shutdowns caused by the long steel strike and other strikes, which will carry over into the second half year.

Outstanding exceptions to the general downward trend of net income were numerous oil producers and refiners as well as many manufacturers of machinery, transportation equip-

NET INCOME OF LEADING CORPORATIONS FOR THE SECOND QUARTER AND FIRST HALF YEAR
(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income Second Quarter 1951	Reported Net Income Second Quarter 1952	Per Cent Change	Reported Net Income Half Year 1951	Reported Net Income Half Year 1952	Per Cent Change
25	Food products	$ 29,709	$ 27,649	— 7	$ 69,330	$ 57,577	— 17
13	Beverages	13,103	11,949	— 9	40,861	21,788	— 47
12	Tobacco products	12,669	11,418	— 10	25,942	21,398	— 18
29	Textiles and apparel	25,285	4,268	— 83	58,676	18,943	— 68
21	Paper and allied products	31,182	22,826	— 27	62,522	47,123	— 25
29	Chemical products	152,262	122,078	— 20	300,551	246,598	— 18
14	Drugs, soap, cosmetics	13,860	15,743	+ 14	38,361	37,212	— 3
32	Petroleum producing and refining	329,597	316,259	— 4	643,586	652,292	+ 1
27	Cement, glass, and stone	49,194	47,148	— 4	99,469	84,243	— 15
23	Iron and steel*	62,529	25,579	— 59	126,519	73,073	— 42
17	Building, heating, plumbing equipment	17,212	11,716	— 32	37,893	21,988	— 42
23	Electrical equipment, radio and television	62,607	57,152	— 9	141,898	120,958	— 15
41	Machinery	31,218	33,983	+ 9	61,076	64,116	+ 5
10	Office equipment	19,436	16,256	— 16	39,386	34,385	— 13
13	Automobiles and trucks	149,984	160,073	+ 7	310,017	298,902	— 4
22	Automobile parts	31,684	26,058	— 18	59,968	51,202	— 15
11	Railway equipment	14,765	13,397	— 9	27,080	26,742	— 1
61	Other metal products	51,205	45,088	— 12	108,230	88,954	— 18
37	Miscellaneous manufacturing	30,464	23,119	— 24	59,896	44,031	— 26
460	Total manufacturing	1,127,960	991,759	— 12	2,311,261	2,011,525	— 13
27	Mining and quarrying	30,763	24,599	— 20	59,371	52,881	— 11
24	Trade (retail and wholesale)	8,178	8,292	+ 1	18,586	13,528	— 27
15	Service and amusement industries	11,811	10,074	— 15	22,463	19,793	— 12
526	Total	$1,178,712	$1,034,724	— 12	$2,411,631	$2,097,727	— 13

* Figures available at this time do not include those of a number of the leading steel producers whose reports have been delayed by the strike.

ment, and other types of durable goods, who achieved an expansion in sales volume more than sufficient to offset their advancing costs. The uneven changes among important lines may be seen from the summary by major industry groups on the preceding page.

The manufacturing companies whose published reports for the first half year include sales figures had combined dollar sales 5 per cent higher than in the first half of 1951. Total costs other than taxes rose by 9 per cent, so that the balance before taxes was cut 13 per cent. After reserves for federal income and excess profits taxes at an average rate of 59 per cent, the net income was down 13 per cent as shown by the following summary, which is partly estimated:

Sales and Net Income of 460 Manufacturing Corporations in the First Half Year
(In Millions of Dollars)

	1951	1952	Change Amount	Change %
Receipts from sales, etc.	$33,526	$35,294	+1,768	+ 5
Total costs, except taxes	27,933	30,433	+2,500	+ 9
Balance before taxes	5,593	4,861	— 732	—13
Fed. income & e. p. taxes	3,282	2,849	— 433	—13
Net income after taxes	2,311	2,012	— 299	—13
Taxes to balance before taxes	59%	59%		
Net income per sales dollar	6.9c	5.7c		

Whereas these 460 manufacturing companies took in $1,768 million more from sales and other operations in the first half of 1952 than in the same period of 1951, this gain in business volume was more than offset by rising expenses, with the result that net income fell by $299 million. The average net profit margin was narrowed from 6.9 to 5.7 cents per sales dollar.

Dividend payments by manufacturing corporations during the first half year showed an increase in dollar total of 5 per cent over the same period of 1951, according to the Department of Commerce compilations of all declarations publicly reported. Most of the increase was accounted for by a gain of 20 per cent in the oil refining group. Among the industries other than manufacturing, there were increases in the mining, public utility, and finance groups, a decrease in trade, and little change in the railroads.

Despite the gain in dollar total of dividend payments, weighted heavily by the increased disbursements made by numerous large organizations, the number of favorable dividend changes during the first half year was exceeded considerably by the unfavorable, as may be seen in the following compilation by the New York World-Telegram & Sun:

	First Half Year 1949	1950	1951	1952
Increased dividends	172	344	306	152
Extra dividends	491	511	561	402
Reduced dividends	132	88	24	84
Omitted dividends	117	66	27	84

The Patman Report

On June 26 Congressman Patman submitted to Senator O'Mahoney, Chairman of the Congressional Joint Economic Committee, the report of his special Subcommittee on General Credit Control and Debt Management. The subcommittee, appointed by Senator O'Mahoney in April 1951, explored many topics but focussed on the policy disputes between the Executive and the Federal Reserve which had been composed only a month before the appointment. The famous accord, reached between the Treasury and the Federal Reserve on March 4, 1951, had unpegged the government bond market and allowed prices to decline below par in response to supply and demand. Congressman Patman, long a stern critic of the Federal Reserve and an advocate of inflationary finance, disapproved the accord and, in light of the preceding controversy, apparently questioned the propriety of the Federal Reserve's refusal to support government security prices at levels desired by the Administration. Sitting with Congressman Patman as members of the subcommittee were Senator Douglas, Senator Flanders, Congressman Bolling and Congressman Wolcott.

The Patman study has many points in common with the Douglas inquiry which, under authorization of a Concurrent Resolution, went over much the same ground in the period July, 1949 to January, 1950. Senator Douglas' group, known as the Subcommittee on Monetary, Credit, and Fiscal Policies, included Senator Flanders, Congressman Patman, Congressman Wolcott and the late Congressman Buchanan as members. Both investigations concentrated on the disputes which arose out of Federal Reserve efforts to move away from the inflationary easy money policies. Both investigations pursued the methods of retaining an economic adviser, sending out questionnaires soliciting facts and views, holding hearings, and issuing a report. Both developed useful collections of data though the immediately vital matters are the conclusions reached and the effects on future legislation and policy decisions.

The Douglas report had no visible effect on legislation but its recognition of the inflationary consequences of bond price rigging was one step toward the decision of the Treasury and Federal Reserve, in March, 1951, to withdraw established price pegs. Congressman Patman signed the Douglas report but had not participated actively in the deliberations and, alone among the Douglas subcommittee members, entered a general reservation on the ground that

the proposals did not make the Federal Reserve System sufficiently responsible to the Executive Department. At other times he has proposed that the Federal Reserve Banks be nationalized and they thereupon use their powers of note issue to "pay off" national debt.

Congressman Patman, in undertaking the new study, promised to try not to inject his particular views into the investigation. He handled the hearings with what Senator Douglas called "the very model of fairness", and did credit to himself by accepting in good spirit a mass of expert testimony contrary to his own expressed opinion. He left the formal drafting of the report to Dr. Henry Murphy, the former Treasury Department adviser who served the subcommittee as economist.

Endorsement of Flexible Policy

The report reveals numerous divergences of view among the subcommittee members. The body of the report itself, which runs to 68 pages, carries no formal signatures, but impliedly is endorsed in full by Congressman Bolling, with stated minor exceptions by Congressman Patman, and with more numerous stated exceptions by Senator Flanders. Senator Douglas, while expressing "cordial agreement" with "much in the present report", entered an eight-page statement indicating differences between the report and his own thinking. Congressman Wolcott concurred with the views of Senator Douglas and indicated his intention to issue a statement of dissent later, as invited to do by Congressman Patman. Senator Flanders on July 4 issued a supplemental statement amplifying his points of agreement and difference.

Nevertheless, it is apparent that agreement was general on many points. In his letter of transmittal Congressman Patman spoke of the "surprisingly large" and "widening" area of agreement on monetary policy and debt management. Most vital is the endorsement given, albeit in cautious language, to the principle that credit policy must be flexible and the Federal Reserve System independent of Executive domination. These were the key recommendations of the Douglas report.

Policy Since Korea

The report enumerates "findings and recommendations" under five main headings. On the first of these, "Fiscal and Monetary Policy Since the Outbreak in Korea", the report professes uncertainty as to whether it would have been wise to have unpegged the government bond market earlier than March, 1951, but gives credit to the more restrictive credit policy pursued since then for helping to check the price rise. The report evaluates the influence of money supply and budgetary position of the Federal Government on price stability and high-level employment and concludes:

> It is only by persisting in appropriate fiscal and monetary policies that the Government can make its full contribution to price stability and high-level employment over the longer period.

Senator Flanders suggests that January, 1950, when the Douglas report came out, would not have been too early for the unpegging, and Senator Douglas, joined by Congressman Wolcott, express the belief that an earlier unpegging would have helped check the "flight from money" which followed the North Korean attack in June, 1950.

Policy for the Future

Under the heading of "Fiscal and Monetary Policy for the Future", the report notes that selective credit controls (such as regulations over instalment and housing credit) interfere with the free operation of the price system and should be used "only when thoroughly justified by special circumstances". Likewise, a voluntary credit restraint program among lenders, such as was invoked from March, 1951 to May, 1952, should be resorted to "only under extraordinary conditions." The goals of price stability and high level employment should be sought by flexible fiscal and credit policies:

> We reaffirm the recommendation of our predecessor subcommittee that a flexible fiscal policy producing a surplus of revenues over expenditures in periods of high prosperity and a surplus of expenditures over revenues in periods of depression should be a principal reliance of the Federal Government in promoting price stability and high level employment.
>
> We believe that monetary policy (variations in the ease or tightness of credit) should also be used as a principal means of seeking price stability and high-level employment. It must be used with caution, however, in order to insure that measures taken to halt an inflation do not aggravate a subsequent period of depression, or *vice versa.*

The final qualifying sentence is one that lacked unanimous support on the subcommittee. Senator Flanders expresses his feeling:

> that resoluteness in the use of monetary policy should be emphasized as well as caution; effective efforts to check inflation should not be unduly inhibited by alarms about possible subsequent depressions, or *vice versa.*
>
> There is much to be said for more frequent small changes in credit policy. This would help get the country out of "crisis psychology" in these matters. Furthermore, skillful steering, whether of an automobile or of the national economy, is brought about by small, frequent adjustments.

Touching on the question of Treasury-Federal Reserve relationship, the object of so much con-

troversy in the past two or three years, the report states:

> Neither the problems of monetary policy nor those of debt management can be solved in isolation from the other. We recommend that the Treasury and the Federal Reserve should continue to endeavor to find by mutual discussion the solutions most in the public interest for their common problems, with final appeal to Congress.

It was in this general area that Senator Douglas expressed his strongest objection:

> I have noted with care the testimony of Mr. Snyder, the Secretary of the Treasury, and of Mr. Martin, the Chairman of the Board of Governors. I would like to compliment them on the ability and good will shown in their oral testimony and on the contributions that their staffs have made to the work of this inquiry. But I strongly urge that the "common responsibility" theory of Treasury-System relations can, in the end, only result in confusion, misunderstanding, and the avoidance of responsibility . . .
>
> Fortunately, the necessary differentiation between the responsibilities of the Treasury and of the Federal Reserve System is easily made. The Secretary of the Treasury has a very great responsibility in advising the Congress with regard to problems in the fields of taxation and borrowing . . .
>
> On the other hand, the problem of the Federal Reserve System is to regulate the quantity of reserve money that it creates, either through its own investment account or lending activities, and to do so, as I believe necessary, in accordance with principles established in law . . .

"Good fences", Senator Douglas goes on to say, "make good neighbors".

The Value of Money

There was wide agreement among witnesses in the hearings that the Federal Reserve must give particular consideration to maintaining the purchasing power of the dollar. Senator Douglas, asserting that the Federal Reserve System has been quite confused regarding its responsibilities and the fundamental reason for its being, urges that Congress amend the Federal Reserve Act to provide a "mandate" to the Reserve System making a clear differentiation between the responsibilities of the Federal Reserve System and the responsibilities of other agencies dealing with money and setting out the price level, along with the levels of employment and production, as a benchmark for policy action.

The text of the report itself considers the declaration of policy in the Employment Act of 1946 as an adequate mandate for economic policy, although regretting a lack of specific mention in that legislation of price stability along with high level employment as ends of economic policy. On the other hand, the report in one passage refers to an unconscious "institutional bias" toward restrictive monetary policy on the part of the Federal Reserve, implying that Federal Reserve staffs are unduly concerned over preserving the value of the dollar. This language is surprising. Most people will feel that the Federal Reserve over the past ten or fifteen years has given too little, rather than too much, attention to restricting the quantity and maintaining the value of its currency. It was an awakening consciousness of responsibility, in an atmosphere of widening public concern over the shrinkage of the dollar, that germinated into policy conflict with the Treasury and, finally, into the bond price unpegging.

Bank Reserve Requirements

On bank reserve requirements the report recommends:

> We believe that nonmember banks should be required to maintain the same reserves as member banks and should be given equal access to loans at the Federal Reserve banks. This change is desirable both in order to increase the effectiveness of credit control and to spread its cost more uniformly over all banks. We see in it no threat to the dual banking system.
>
> While we see no immediate need for the imposition of higher reserve requirements or for reserve requirements of new forms (e.g., requirements which might be met in whole or in part by United States securities or requirements expressed as percentages of assets rather than of liabilities), we believe that further consideration should be given to the adoption of legislation providing the Board of Governors with additional powers over bank reserve requirements for use at its discretion. The time to provide such powers is during a period of quiescence in inflationary pressures and not when the discussion of them would dramatize and so intensify existing pressures.

The first of these proposals has come up before in one form or another and uniformly has been rejected by the Congress. While it sounds good, it involves some thorny Constitutional issues and would undermine the voluntary character of the Federal Reserve System. Only 15 per cent of bank deposits in the United States are not now covered under the Federal Reserve System formula of reserve requirements.

The second point follows the line of recommendation of the Council of Economic Advisers that the Federal Reserve should be given power to impose at its discretion almost any kind of reserve requirements on the member banks. A principal purpose would be to "insulate" the government securities market from changes in interest rates. Senator Douglas opposes as "utterly mischievous" the use of reserve requirements "to create a captive and coerced market" for government bonds. Neither the Secretary of the Treasury nor the Chairman of the Federal Reserve Board recommended the grant of such

powers. Discussing a reserve requirement plan of this sort, the Federal Reserve Bank presidents pointed out that it "might become a device for financing federal deficits cheaply rather than a tool which would contribute to effective monetary policy."

Machinery of Monetary Policy

A fourth heading among findings and recommendations is "The Machinery for the Determination of Monetary Policy." The independence of the Federal Reserve System, the report states, is *within* and not *from* the government, and is based, "not on legal right, but on expediency":

Congress, desiring that the claims of restrictive monetary policy should be strongly stated on appropriate occasions, has chosen to endow the System with a considerable degree of independence, both from itself and from the Chief Executive. This independence is in no way related to the unsettled question of whether the Board of Governors is or is not a part of the Executive Branch of the Government. It is naturally limited by the overriding requirement that all of the economic policies of the Government — monetary and fiscal policy among them — be coordinated with each other in such a way as to make a meaningful whole. The independence of the Federal Reserve System is desirable, not as an end in itself, but as a means of contributing to the formulation of the best over-all economic policy. In our judgment, the present degree of independence of the System is about that best suited for this purpose under present conditions.

In his supplemental statement Senator Flanders expresses a strong belief in the independence of the Federal Reserve System from the Chief Executive and describes the true significance of this independence:

The report states that it is the duty of the President to seek to coordinate the economic policies of the Government. This is implicit in the office of the Presidency. It is, furthermore, a duty which has been placed upon him by the Employment Act of 1946. But the report is also emphatic that the Federal Reserve System should be the sole judge of the uses to which the instruments of credit policy entrusted to it should be put. The Federal Reserve has equally the duty of urging its views on the President in order to secure the adoption of what it believes to be sound over-all economic policies. It is in the strength given it by sole discretion in the use of its own policy instruments that the true significance of the independence of the Federal Reserve System is to be found.

The report would modify the top command organization of the Federal Reserve System by reducing the number of members of the Federal Reserve Board from 7 to not more than 5, cutting their terms of office from 14 to 6 years but making them eligible for reappointment, removing qualifications for the office, increasing salaries to the cabinet level of $22,500 for the chairman and to $20,000 for the other members, and having the President name the chairman for the four years corresponding to his own term. The number of Federal Reserve Bank presidents, now 5, serving on the Federal Open Market Committee would be reduced proportionately with the reduction in the size of the Federal Reserve Board.

The report endorses Treasury Secretary Snyder's suggestion that a consultative and advisory council be established, experimentally, composed of the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of the Budget, the Chairman of the President's Council of Economic Advisers, and the Chairman of the Securities and Exchange Commission. The council, without directive powers over its members, would discuss domestic monetary and fiscal matters with each other and report to the President.

These recommendations of organizational changes encountered a good deal of disagreement within the subcommittee. No one objected, for example, to the salary adjustment for Federal Reserve Board members, something that is overdue, but Senator Flanders dissented from so great a reduction in their terms of office, which would give a President power to appoint a majority within a four-year term of office. Senator Douglas hinged his opposition to many of these recommendations on the absence of a policy mandate in law and the dangers under such circumstances that the System "would be effectively brought into subservience to the currently ruling Executive and his political purposes":

these recommendations might, under other circumstances, represent desirable but minor changes. Nevertheless, I believe them to be dangerous in the absence of a clear mandate making the Board of Governors fully responsible for the monetary policies it pursues and in the absence of a statement of the general principles of monetary policy for which the System is accountable.

Gold

The final section of the findings and recommendations is entitled "The Gold Standard." It affirms that the present form of gold standard "has proved its worth in maintaining the stability of the United States dollar in world markets" and opposes restoration of free domestic convertibility of paper money into gold.

This section is something of a curiosity. Although the report is entitled "Monetary Policy and Management of the Public Debt", the monetary standard did not figure in the investigation. The only subcommittee member who brought up the question during the hearings, Congressman Wolcott, threw out the provocative idea of

dissolving the International Monetary Fund and initiating an international monetary conference "looking to the possible restoration of the gold standard". European nations seem to be looking in this direction as a means to reestablishing public confidence in paper currencies. The Patman inquiry made no attempt to deal with these ideas nor with the ambiguities in our present gold standard and gold laws. The Douglas report, two and a half years ago, while rejecting free domestic convertibility "at this time", recommended a Congressional review of gold laws "with a view to repealing any legislation that might be so construed as to permit a change in the price of gold by other than Congressional action". This suggestion remains to be followed up, not to mention the larger question raised by Congressman Wolcott.

Concluding Comments

The report has little or nothing to say on two areas included in its frame of reference: the adequacy of the existing banking structure to serve the needs of both depositors and borrowers; and debt management policy. There are no findings or recommendations whatever on the former subject although the "Replies to Questions" volume put out by the subcommittee contains 140 pages, plus numerous maps, portraying and discussing banking and credit facilities with particular reference to small business. This material, the greater part supplied by the twelve Federal Reserve Banks, is valuable simply from the standpoint of suggesting the breadth and depth of the financial machinery required for the functioning of the American economy.

The report advises against the issuance of so-called purchasing power bonds, and approves recent changes in the Savings bond program but otherwise has no advice to offer the Treasury on the management of the public debt. Implicit in the findings and recommendations, however, is the basic principle that the Treasury should design securities that will sell without the Federal Reserve's having to manufacture money to pay for them.

The biggest value of the Patman inquiry does not rest on detailed recommendations nor on its compilations of data. The biggest value lies in the overwhelming weight of testimony favoring independence of the Federal Reserve from political pressures and the universal agreement on the inflationary risks in using the Federal Reserve to supply the Treasury with cheap credit. Acceptance of these principles stands as a very real gain.

More on Gold

In the July issue of this Letter we referred to two developments of importance concerning gold. One was dramatic evidence of returning appreciation of gold as a monetary base and standard of value which people can trust. This was afforded by terms of the French Government's new "gold loan" offered in May. Here the significant feature was a guarantee as to principal against currency depreciation by provision making the bonds redeemable at premiums proportionate to any increase in the free market price of the 20-franc gold piece – the louis, or the napoleon.

The other development was the decline in the French hoarding demand for gold. This was reflected both in the substantial cash subscriptions to the new loan and in a decrease in the price of coin and bar gold in the Paris market. Though it cannot be said that the battle of the French franc has been won, the ability of the Pinay Government to surmount political crises, together with its efforts at balancing the budget and halting inflation, have inspired more confidence in the currency. This has led not only to a lessened demand for gold, but also to an improvement in the exchange rate of the franc against the dollar.

But there is much more to be said about gold than was told in these columns last month. The fact is that not only in France but elsewhere the demand for gold for private holding has diminished and prices quoted for the metal on free markets have fallen, narrowing the gap between the dollar equivalents, and the official price of $35 an ounce established by the U.S. Treasury. Because of the bearing of these developments upon such major questions as the future monetary price of gold and the adequacy of the monetary reserves held by central banks and governments as currency backing, we are prompted to revert to the subject of gold. Both the willingness of private gold hoarders in the postwar period to bid high prices for gold, and the constant seepage of gold into non-monetary channels, have been cited as evidence that the official $35 an ounce price is too low and must sooner or later be raised.

Growth of Postwar Premium Gold Markets

In pursuing this subject it is necessary, first, to say something about the premium gold markets that sprang up after the war in various parts of the world. These arose primarily from three causes:

1. The age-old instinct of people in times of political and economic uncertainty, fears of cur-

rency depreciation, etc., to turn to gold as the safest haven for their savings;

2. The normal tendency in the Far East in times of prosperity and high prices for people to invest their savings in gold; and

3. A belief in many quarters that the price of gold is too low and will have to be raised; hence that the purchase of gold would be a good speculation for the rise.

Prices quoted in these premium markets have varied widely. In general, they have tended to be high in periods of intensification of the demand factors listed above, and to ease off as the force of these influences has abated. More recently, the increased flow of gold attracted to the premium markets by high prices has been a factor damping down price advances and accentuating price declines.

Variations in gold prices from market to market reflect many factors: transportation costs, local currency exchange risks, taxes, and the freedom with which gold can be imported and exported as well as traded within the country. In countries where gold imports are subject to official license, as is generally the case, gold prices reflect mainly supply-demand relationships within the local market, including such factors as extent of gold sales for government account and the facility with which import licenses can be secured or gold smuggled into the country. In most countries private imports of gold are prohibited, and gold brought in unofficially has to be smuggled at varying cost and risk.

The following table will give the reader an idea of the wide variations that have taken place in free gold prices in leading trading centers during the postwar period. Prices are given in dollar equivalents of local currencies based on free market rates except in the case of Bombay and Alexandria where the official rates are used.

Free Market Gold Prices

U. S. Dollar Equivalents of Local Currencies, per Fine Ounce of Bar Gold

End of Month	Paris	Zurich	Tangier	Hong Kong	Bombay	Alexandria
1946, Dec.	$ 62	$ 47	$ 63*	$ 51	$ 81	$ 67
1947, Dec.	53	42	53	50	83	71
1948, Dec.	49	43	57	49	91	63
1949, Sept.†	52	46	47	47	92	64
Dec.	46	41	40	39	64	47
1950, June‡	39	37	37	38	63	42
Dec.	41	40	40	45	63	43
1951, June	43	40	40	43	64	44
Dec.	41	39	39	42	60	45
1952, June	38	37	38	40	56	—

* January 1947. † Prior to the general currency devaluation. ‡ Prior to the outbreak of Korean war. Source: Bulletin Mensuel de Statistique, Paris; Dr. Franz Pick's publications; Dr. M. A. Kriz' Annual Gold Reviews published in Engineering and Mining Journal.

In western Europe prices in the postwar period have gone as high as $60 an ounce. Even higher prices have been reported in other parts of the world, notably India where quotations have exceeded $90 an ounce. In considering the significance of such prices it should, however, be expressly noted that they do not cover actual sales of gold against dollars, but are merely dollar-equivalents of local currency prices. Obviously a great deal depends upon the degree of realism in the exchange rate. Where conversion is at an overvalued official rate the resultant dollar price reflects not the true relation between gold and the dollar, but rather the degree of depreciation of the local currency. On the other hand, where the conversion is made at a free market rate for the dollar, a resultant premium measures a preference for gold over dollars.

Efforts to Control Premium Gold Traffic

Despite risks and impediments the premium gold markets continued to flourish and attract metal on a large scale. As will be seen from the table below, compiled from the 1952 annual report of the Bank for International Settlements, newly-mined gold absorbed into non-monetary uses – the arts, industries, and private hoards – reached large proportions during the postwar years. In 1951 a new record was established at 82 per cent.

Estimates of "Disappeared" Gold

(In Millions of Dollars)

Year	Gold Output (a)	Increase in official Gold Reser.	'Disappeared' Gold	Industrial Uses	Private Hoarding
1946	763	350	413	280	133
1947	774	430	344	120	224
1948	798	380	418	170	248
1949	833	480	353	200	153
1950	858	410	448	210	238
1951	844	130	714	220	494
1946-51	4,870	2,180	2,690	1,200	1,490

(a) Excluding Russia. Source: Twenty-Second Annual Report of The Bank for International Settlements.

This diversion of gold from official monetary reserves into private use has been viewed with increasing concern by the monetary authorities. As early as 1947 the International Monetary Fund made known its objections to international transactions in gold at premium prices, and in a strongly worded statement to all its member countries recommended that they take "effective action" to suppress this traffic.

That the Fund was fighting a losing battle soon became apparent. Despite Fund objections more and more gold flowed into the premium markets, attracted by the high prices which in turn reflected the searchings of people for a reliable store of value. By 1951 the Union of South Africa, which in 1949 had, with the approval of the Fund, commenced to sell "in-

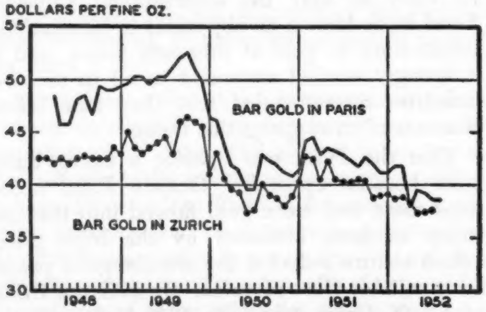
dustrial gold" and fabricated art objects at premium prices, was disposing of 40 per cent of its total gold output in this fashion. And other countries were following suit. By 1951 so extensive had this traffic become, despite Fund efforts to control it, that over 80 per cent, as we have seen above, of total world gold production (outside Soviet Russia) was disappearing into unreported holdings. Not only that, but even some monetary gold was finding its way into premium markets with the view to earning extra dollars. As the London Banker commented last November:

> When the premium is high enough, as it was at periods last year, nimble and ingenious operators can usually find ways and means of abusing facilities by which central banks and governments make gold available to one another at official prices—and may by such means contrive to resell some of that gold at the handsome profit offered in the premium market.

In September last year the Monetary Fund was ready to throw in the sponge, and announced that it would leave to member countries the practical operating decisions involved in implementing its gold policy. Given this green light British East and West Africa and Southern Rhodesia stated their intention to market about the same proportion of new gold as South Africa in premium markets, i.e., 40 per cent. More recently the Rhodesians began to sell their entire output in the free market. Other producing countries, Canada, Australia, and the Fiji Islands also moved to permit sales of their output at premium prices, though most of the Canadian producers are reported to have found it more profitable to collect mining subsidies than to accept the premium.

Decline of Premium Prices

All this, of course, has had an effect in the gold markets and, along with lessened demand proceeding from the subsidence of inflationary fears, has contributed to lowering gold prices. As shown by the accompanying diagram, the free market prices for gold in Zurich and Paris have once more declined to the pre-Korean level of around $37 and $39 an ounce, respectively. Prices of so-called "transit gold" in Paris, i.e., gold imported for resale abroad, sold down to around $36½.



Prices of Bar Gold in Paris and Zurich (Prices in Dollars per Fine Ounce at Free Market Exchange Rates)

In Paris, now the principal center for private gold trading, bar gold which was around $60 an ounce at the end of 1946 dropped to about $49 an ounce by the end of 1948, reflecting the returning confidence after the Marshall Plan was adopted. However, under the influence of currency devaluation rumors the price rose above $50 an ounce by August 1949. Renewed confidence in currencies once the devaluations were "over and done with", coupled with more plentiful supplies of new gold in premium markets, sent the price down to new postwar lows, until the Korean invasion and subsequent international tension turned it up once more. The new upsurge in the spring of 1951 reflected enhanced fears of the inflationary impact of rearmament. More recently gold prices have again declined, with the downturn in commodity prices and more serious efforts by many countries to control inflation by balancing their budgets and resort to more active measures to restrain credit expansion.

Thus experience so far has appeared to bear out the views of these authorities on gold who have contended right along that the premium prices would melt away once gold was permitted to move freely in international markets and fears about the value of money began to wane. It supports the admission by Mr. Ivar Rooth, managing director of the International Monetary Fund, at the conclusion last September of that body's four-year struggle against the premium gold trade, that—

> The only dependable way of getting rid of premium gold markets and private hoarding of gold is to create economic conditions under which the private demand for gold will become negligible . . . In every country, the best way to reduce the demand for gold for private hoards is to follow budget and credit policies that will give people confidence in their currency. Nobody can have a good reason for hoarding gold or paying a premium for gold in a country in which the currency will remain stable in internal and external value.

As the 1952 annual report of the Bank for International Settlements says in its review of the gold movements and prices over the past year:

> It is an object lesson for all and sundry that, if supplies of gold are allowed to move freely and if confidence in the national currencies is restored, these two factors are capable of putting an end to gold hoarding, after all attempts at suppression by means of prohibitions and controls had failed.

Taxes and Food Costs

Tax collections in the United States this year are setting a new high record for all time, far above the former peak established in the last full year of World War II. Treasuries of federal, state, and local governments are taking in more billions of dollars than ever before as a result of increased rates and new types of taxes, applied at boom levels of business activity and national income.

A new estimate of how high tax collections have actually risen has just been issued by the National Industrial Conference Board in a pamphlet of charts entitled "How Much Government?" This places the grand total for the 1952 fiscal year at the staggering sum of $87 billion, compared with around $70 billion in 1951 and a range of $52-57 billion in the years 1944-50. The 1952 estimate, necessarily subject to revision until the final figures reported by some 119,000 different government organizations are tabulated several years hence, is made up as follows:

Estimated Federal, State, and Local Government Tax Collections in 1952

(In Billions of Dollars)

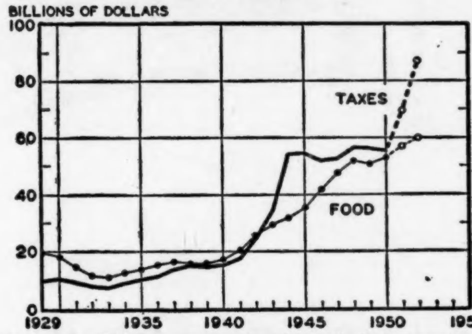
Individual income	$30.3
Corporate income	23.6
Excises and sales	12.3
Social insurance	6.2
Property	8.2
All other, including customs	6.8
Total	$87.3

Even this huge total of tax collections does not cover fully the total of government spending. The federal portion (including social security taxes) of $67.4 billion is the highest in the country's history, yet some $4 billion short of balancing the budget in the fiscal year ended June 30, 1952. For fiscal 1953, President Truman has estimated that the deficit will jump to $14 billion, despite a further large rise in tax collections. Total cost of government, including state and local, in the coming fiscal year is expected to exceed $100 billion.

Taxes Exceed the Food Bill

Most people simply cannot comprehend a figure such as $87 billion representing the estimated national tax load. Such an aggregate takes on meaning only if comparison is made with something familiar, as the nation's bill for food, computed each year by the U.S. Department of Commerce as part of a continuous study of national income and its components. Consumer expenditures for food have followed a sharply and almost uninterrupted upward trend since the outbreak of World War II. Latest annual figures available are $52.8 billion for the year 1950, which includes meals purchased, meals furnished to government and other employes, and an allowance for food consumed on farms, but excludes expenditures for alcoholic beverages and tobacco products. Current statistics on monthly sales by food stores and restaurants indicate that the total may have risen by 1951 to around $57 billion, and in 1952 may reach $60 billion.

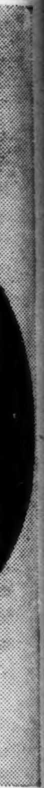
Thus despite a national food bill that more than trebled since prewar, reflecting the inflation of general prices, government expenditures of many billions to hold up farm products, and a substantial long-term growth in population, the national tax bill soared even higher as may be seen from the accompanying chart.



Total Tax Collections Compared with Total Food Expenditures in the U. S. 1951-52 Partly Estimated

Traditionally the expenditures for taxes have run well below those for food. During the war, this relationship changed; taxes then moved above food, and have since stayed above. The soaring tax load in 1952 carried the estimated total almost half again as high as the food total. Taxes exceed by even wider margins the four other major categories of consumer expenditures — clothing, housing, house operation, and transportation.

Unfortunately, this fact is not recognized by the average family in its budget, for the reason that less than half of the tax total is paid directly by individuals in the form of income, sales or property taxes. The major or "hidden" portion is paid by business — corporations, partnerships and proprietorships — in a multiplicity of different taxes that tend, along with other costs, to be passed on to the purchaser in his cost of living. Although it is less unpopular politically to levy taxes upon business than upon individuals, and although business often has to absorb some of the tax, it acts for the most part as collecting agent. Taxes must in the last analysis be borne by the people, who now pay more for being governed and defended than for eating.



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